

The Role of “Physical Space”: New Constraints for Retail in a Post-COVID World



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In an [earlier COVID-19 article](#), we addressed how COVID-19 might impact consumer spending habits. In addition to shifts in spending behaviors, the very location where said spending occurs will be transformed. Retailers who anticipate these changes and strategically plan for it will fare best on the other side of this crisis and ultimately, become an attractive model for strategic interest from investors. Attention now will help ensure better positioning post-crisis for future growth (and at what pace) or a prospective sale or capital raise.

OFFERING MORE “PHYSICAL SPACE” TO SPUR SPEND

One of the more prolific implications for retailers upon re-opening will be ‘where’ the consumers will shop. “Social distancing” has moved to the fore of American’s vocabularies – and delivering it to shoppers, whether real or perceived, will become a key responsibility for retailers. Main Street location of small and mid-sized towns, lifestyle shopping centers, even outlet malls, could all be significant beneficiaries because they boast more square footage and outdoor walkways for space conscious consumers. Retailers in those venues have a unique opportunity to create customer connections in environments where the customer is most comfortable.

The above-mentioned traffic trends are yet another body-blow for traditional malls which were already under unrelenting pressure. There is undoubtedly going to be significant retail closures over the next 18 months which could result in 15%+ of square footage coming out of the still over-stored US economy. Assuming retailers remain within the construct of their leases, it will be incumbent on them to consider new and different ways to utilize their existing space in malls given these traffic trends. Savvy retailers will ask themselves: Can my store serve more needs that just selling products – integration of services, utilization as local delivery distribution points to consumers, opportunities for one-to-one engagement, potential for alternative uses of a portion of the space for conversion to apartments and other lifestyle formats?

Retail Store Closures

Year	Total Closures	% Change
2017	6955	n/a
2018	5,524	(20.6%)
2019	9,302	68.4%
2020E	15,000	61.0%

Source: Coresight Research

Weekly Retail Traffic YoY Change

Week Ended	1/3/20	1/10/20	1/17/20	1/24/20	1/31/20	2/7/20	2/14/20	2/21/20	2/28/20	3/6/20	3/13/20
YoY % Change	4.9%	(1.4%)	(4.9%)	3.2%	3.9%	(7.3%)	(2.7%)	(2.6%)	(3.3%)	(9.1%)	(30.7%)

Source: Prodc Analytics via Bloomberg

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"PHYSICAL SPACE" REMAINS CRITICAL IN OMNI-CHANNEL SELLING

At the same time, perhaps counter intuitively, we believe there will be increased expectations for direct-to-consumer only, digitally-native brands to generate sustained consumer mind share through customer engagement in a physical environment. If there is one thing that has been proven in recent years, it's that customer acquisition through online only marketing channels is expensive, lends itself to price shopping, and generally does not result in optimized long-term customer stickiness. We've seen many digitally-native brands address these challenges by opening small, showroom style physical locations often in lifestyle or local markets, but funding will become more challenging for a go-it-alone strategy. Hence, there are opportunities for large retailers to acquire and integrate digitally-savvy brands into their business and create enhanced customer connection. Retailers need to consider their business as a 'consumer eco-system' with multiple product, content, service, delivery and geographic considerations.

Going forward, it will not be good enough for retailers to simply be "omni-channel". Retailers need to operate with a fully-integrated, all-channel approach that creates a seamless physical footprint as well as a digital offering, content, services, and engagement. Yes, the large category winners will continue to win on a product driven basis – WMT, Coscto, HD, Dollar General, Amazon, etc. – but the plethora of other retailers need to think well beyond just a product offering and well beyond even an omni-channel product offering.

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LINCOLN PERSPECTIVE

Retail M&A deal making will remain largely stalled until an emergence from the health crisis provides an ability to determine consumer purchasing patterns in the "new normal" environment. Pent-up shopper demand may offer decent revenue numbers for retailers who offer an environment that draws customers who consider browsing and shopping a hobby they've had on pause for several months. Retail will always play an important role in delivering a holistic assortment of products, services, and content to consumers and there are several ways retail companies will be important to go forward M&A strategies.

Strategic buyers of retail assets and PE-backed retail platform companies will seek more diversified and transformational M&A to create unique models that can share competencies across a platform and create true customer connection and a defensible eco-system. Examples of go forward retail M&A include:

Retailers will buy and/or merge with Consumer Services businesses to create multiple occasions to interact with the target customer

Controlled brand acquisitions will become increasingly important for retailers to create "scarcity value" and drive customers to engage in an "all-channel" manner

Direct to consumer, digitally-native brands will increasingly become important acquisition targets for brick and mortar retailers in order to accelerate customer touch points across the physical and digital world

The retailers that make it through this period of dislocation and utilize M&A and other strategic initiatives to create a business model that encompasses the themes mentioned above have an opportunity to transform themselves into winning models during a critical period of change and position themselves for premium valuations in the future.

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